APPENDIX A

SUPREME COURT OF ALABAMA

No. 1961555

STATE OF ALABAMA, ET AL.

v.

ALABAMA MUNICIPAL INSURANCE CORPORATION, ET AL.

Appeal from Montgomery Circuit Court
(CV-95-516)

May 22, 1998

MADDOX, Justice.

This appeal involves a question of the constitutionality of Alabama statutes that create tax credits in favor of insurance companies that issue property and casualty insurance policies. Eight insurance companies contend that §§ 27-4A-3(a)(3)d.1. and d.2., ALA. CODE 1975, which create tax credits that result in a reduction of the insurance premium tax, are discriminatory when applied and that they, therefore, violate §§ 1 and 35 of the Alabama Constitution of 1901 and/or the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution.

The parties raise the following specific questions:

(1) Did the trial court apply the appropriate principles of law in ruling on the constitutionality of the tax credits?

(2) Does the State's granting of the tax credits violate either the Alabama Constitution or the United States Constitution?

(3) If the tax credit statutes are held to be unconstitutional, should they be severed from the premium tax statute? and

(4) Whether the trial court, upon determining that the tax credits were unconstitutional, erred in applying that determination quasi-prospectively?

FACTS AND PROCEDURAL HISTORY

In the early 1980s, a group of foreign insurance companies challenged the constitutionality of the insurance premium tax then in effect, on the grounds that it violated the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution. The tax scheme then in effect imposed either a 3% or a 4% premium tax on an out-of-state insurer, depending on the kind of insurance the company sold, but only a 1% tax on a domestic insurer, without regard to the kinds of insurance the domestic company sold. Although the Alabama statutes then applicable allowed for the reduction of the tax rate on foreign insurers if those companies met certain requirements (e.g., investing a percentage of their assets in Alabama), there was no method under the old taxing scheme for a foreign insurer to achieve parity with a domestic insurer on the tax rate charged on premium collections.

Alabama's old taxing scheme was challenged on constitutional grounds in *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869, 105 S. Ct. 1676, 84 L. Ed. 2d 751 (1985). The United States Supreme Court held that Alabama's insurance premium taxing scheme was unconstitutional, on the ground that it discriminated against foreign insurers.

After the Supreme Court rendered its decision in *Ward*, the out-of-state insurance companies involved in that case entered into a settlement with the State. Under the terms of the settlement agreement, the out-of-state companies, as plaintiffs, consented to the dismissal of their action in exchange for legislation that would redesign the tax system relating to the insurance premium tax. Accordingly, the Legislature enacted the Insurance Premium Tax Reform Act of 1993 (the "Act") (Act No. 93-679, ALA. ACTS 1993;

codified at ALA. CODE 1975, § 27-4A-1 to -7); that Act contains the sections that the eight plaintiffs in this case now challenge as violating both the State Constitution and the Federal Constitution.

Because the Act made major revisions to the State's premium taxing scheme, we briefly describe how it was designed to be applied. The Act first provided that every insurer, whether foreign or domestic, is taxed at a rate of 3.6% on property and casualty insurance premium income. Despite the equalization of the basic premium tax rates under the new system, the plaintiffs filed this action in the Montgomery Circuit Court in March 1995, against the State and Michael DeBellis, insurance commissioner for the State of Alabama (collectively the "State"), charging that the new tax system violates the Fourteenth Amendment to the United States Constitution and §§ 1 and 35 of the Alabama Constitution. Specifically, they charged that two tax credits included in the premium tax statute are discriminatory and, therefore, unconstitutional.

The plaintiffs first challenged the tax credit designated as the "Alabama Insurance Office Facilities Credit" (the "Office Credit"), which provides for incremental reductions in an insurer's tax rate for each office that it operates within the state, with the amount of the reduction per office dependent on the number of employees working in that office.[1] The

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[1] The statute provides:

"1. Alabama Insurance Office Facilities Credit.

"For each office owned or leased by an insurer in the State of Alabama and used for insurance operations, an insurer shall be entitled to a credit against the [premium tax] according to the following schedule:

plaintiffs also challenged the tax credit designated as the "Alabama Real Property Investment Credit" (the "Property Credit"), which provides for incremental reductions in an insurer's tax rate based on the amount of investment in real property the insurer has made within Alabama.[2]

The trial court held that the tax credit formula was unconstitutionally discriminatory because it was easier for larger companies with more offices and more employees to take advantage of the tax credit. The trial court specifically held:

Number of Full Time Employees in Office	**Credit as a % of Premiums Taxable under Paragraph a.**
1-3	0.0025%
4-10	0.0050%
11-50	0.0075%
51 or more	0.0100%

"The total credit allowable for Alabama insurance office facilities shall not exceed one percent of an insurer's Alabama premiums taxable at the rate specified in paragraph a. of this subdivision (3)." § 27-4A-3(a)(3)d.1., ALA. CODE 1975.

[2] The statute provides:

"2. Alabama Real Property Investment Credit.

"For each $1,000,000 in value of real property investments in the State of Alabama, an insurer shall be entitled to a credit of 0.10 percent of its Alabama premiums taxable at the rate specified in paragraph a. of this subdivision (3). The total credit allowable for Alabama real property investments shall not exceed 1 percent of an insurer's Alabama premiums taxable at the rate specified in paragraph a. of this subdivision (3)."

§ 27-4A-3(a)(3)d.2., ALA. CODE 1975.

"The [statutory] section under scrutiny taxes property and casualty premium income (with certain exceptions) at 3.6%. Section 27-4A-3(a)(3)d.1. provides incremental credit up to 1% for a specified number of offices staffed by a specified number of employees. Section 27-4A-3(a)(3)d.2. provides a credit of .1% for each one million dollars invested in real estate in Alabama up to an investment of ten million dollars or a maximum credit of 1%.

". . . .

"Under the taxing statute, it is easier for a large company to take advantage of the [Property Credit] than a small one. A company with less than one hundred million dollars in assets is effectively prohibited from investing as much as ten million dollars in real estate by § 27-41-34 . . . . Similarly, it is easier for a company doing a large amount of business in Alabama through employees to take advantage of the [Office Credit], than a small one doing business through independent agents. The minimum number of offices a company must have to achieve the full credit is 100, staffed by 51 employees each, or a total of 5,100 employees . . . . The taxing classification thus favors larger companies and concurrently burdens smaller ones.

". . . .

"This Court finds and concludes that the subject tax discriminates in favor of large companies and burdens small ones. . . . The State suggests that if anything is held unconstitutional, it should be the credits . . . . The Court finds that the credits are an integral part of the section taxing property and casualty companies and cannot be severed from it."

Because the trial court held that the two credits were integral to the premium taxation scheme, it held the entire

premium tax unconstitutional and ordered refunds for the plaintiffs; it did not order refunds for similarly situated insurance companies, holding instead that its judgment was to be prospectively applied to all other such companies.

The trial court held that the challenged tax credits violated what it called the "equal protection" provisions of the Alabama Constitution, i.e., §§ 1 and 35, and accordingly did not reach the question whether they also violated the United States Constitution.

The defendants appealed. We have carefully reviewed the briefs of the parties and have carefully considered the oral arguments. Based on the reasons discussed below, we reverse and remand.

DISCUSSION

In our analysis of whether the challenged tax credits violate §§ 1 and 35 of the Alabama Constitution, we must first note that, as a general principle, acts of the legislature are presumed by this Court to be valid and that this Court "seek[s] to sustain rather than strike down the enactment of a coordinate branch of the government" and that it will not hold such an act unconstitutional "unless it is clear beyond reasonable doubt that [the act violates] the fundamental law." *Alabama State Federation of Labor v. McAdory*, 246 Ala. 1, 9, 18 So. 2d 810, 815 (1944). In *McAdory*, this Court also stated that when a court is passing upon the constitutionality of a legislative act, "questions of propriety, wisdom, necessity, utility, and expediency [of the act] are held exclusively for the legislative bodies, and are matters with which the [court has] no concern." 246 Ala. at 9, 18 So. 2d at 815.

Regarding the taxing power, we also note that "'in taxation, even more than in other fields, legislatures possess the greatest freedom in classification.'" *Thorn v. Jefferson County*, 375 So. 2d 780, 786 (Ala.1979), quoting *Madden v.*

Kentucky, 309 U.S. 83, 88, 60 S. Ct. 406, 84 L. Ed. 590 (1940). This Court has discussed the taxing power as follows:

> "[T]he power to tax is essentially an attribute of sovereignty conferred by the people, through the constitution, on the state, and is vested in the legislative department. . . . Legislative classifications in tax matters are presumably valid, the burden being on the challenger to prove that such a classification or subclassification does not rest on a reasonable basis and such statutes are not to be deemed unconstitutional or invalid if any state of facts can be conceived which would support the subject of the tax."

Haden v. Watson, 270 Ala. 277, 281, 117 So. 2d 694, 696 (1960). Similarly, as the Court of Civil Appeals has written:

> "The power of the legislature to exempt from taxation unless restricted by express constitutional provisions is as broad as its power to tax. The legislature is free to exempt according to its views of public policy and expediency.

Barron-Leggett Elec., Inc. v. Department of Revenue, 336 So. 2d 1124, 1127 (Ala. Civ. App. 1976) (citations omitted).

The burden the plaintiff must meet in showing that a taxation statute is unconstitutional is stringent.

> "It is the law, of course, that a party attacking a statute has the burden of overcoming the presumption of constitutionality, of negativing every conceivable or reasonable basis which might support the classification, and of showing clearly that the statute is unjustly discriminatory or that the classification is essentially arbitrary or unreasonable. Discrimination is the essence of classification and does violence to the constitution only when the basis of the discrimination is unreasonable."

Thorn, 375 So. 2d at 787.

The plaintiffs here urge this Court to apply the "means-ends" test of State ex rel. *Galanos v. Mapco Petroleum, Inc.*, 519 So. 2d 1275 (Ala. 1987), to the facts of this case. As the State correctly points out, this Court has not previously applied the "means-end" test to cases involving the constitutionality of taxation statutes. In *Mapco*, this Court enunciated a rule to be used in determining whether certain statutes violated the protections embodied in the Alabama Constitution. However, a review of *Mapco* makes it evident that this Court was not in that case formulating a test for determining whether taxation statutes were constitutional. In a thorough opinion, the *Mapco* Court examined the development of constitutional analysis of economic statutes, but it did not discuss the long line of cases in which this Court has considered the constitutionality of taxation statutes. Further, in that section of *Mapco* where this Court set out the test described by some as the "means-ends" test, this Court introduced that test with the following:

> "After due reflection, we determine that the following standard should be applied in review of a challenge such as this one to the constitutionality of legislation prohibiting sales below cost in the attempt to prevent monopolization...."

519 So. 2d at 1284. Based upon our understanding of this Court's holding in *Mapco*, we can conclude only that in that case this Court did not overrule its long line of precedents governing our consideration of the constitutionality of taxing statutes.

Having determined that we should not apply the *Mapco* test, we apply the principles this Court has previously applied in cases involving questions of the constitutionality of taxation statutes. Applying those principles, we conclude that it is not clear beyond a reasonable doubt that the tax credits at issue

violate either the Alabama Constitution or the Federal Constitution.

The plaintiffs have not shown that, because they are unable to take advantage of the tax credits, the application of the tax credits has produced an inequality that is "actually and palpably unreasonable and arbitrary." *McAdory*, 246 Ala. at 12, 18 So. 2d at 817. The statute in question imposes a flat premium tax rate on all insurers, foreign and domestic, without exception. The credits challenged are based on objective, clearly ascertainable criteria. Although we recognize that some companies are economically unable at this time to qualify for the credits, we must also recognize that their inability to qualify is a result of their own business decisions and their own economic performance. We are not unaware of the argument that some insurers are prevented from investing the maximum amount in Alabama real estate because their total assets are too low. However, we note that the conditions prevailing today are not necessarily constant. Those companies could grow and thus be able to invest more. We find persuasive the State's argument that the statute does not discriminate, in that it does not create classes of insurers to be treated differently from other classes.

A statement of the Minnesota Supreme Court, in a case where it rejected an equal protection challenge to a taxing statute, could be applied in this case:

> "Furthermore, any difference of effect that may have arisen from the [statute] is the result, not of discriminatory treatment, but of the unique financial situation of individual insurance company taxpayers."

John Hancock Mutual Life Ins. Co. v. Commissioner of Revenue, 497 N.W.2d 250, 254 (Minn. 1993). In this present case, the insurance company taxpayers who meet the clear and objective criteria have been treated equally.

A party challenging a tax statute as unconstitutionally discriminatory must show that the discrimination embodied in the taxing statute is unreasonable and must negate every factor offered as a reasonable basis supporting the classification. The plaintiffs have not met that heavy burden in this case; therefore, we reject the plaintiffs' argument that the challenged tax credits violate the provisions of the Constitution of Alabama.

Although the trial court did not reach the question whether the challenged tax credits violate the Equal Protection Clause of the United States Constitution, we note that the federal constitutional issue was argued before this Court in the parties' briefs and at oral argument. Furthermore, if this case were remanded to the trial court for further consideration, that court would necessarily have to rule on the federal constitutional issue. Therefore, we have decided to address that issue now.

When a court is analyzing the constitutionality of a taxation statute under Equal Protection Clause jurisprudence, the appropriate test for the court to apply is the "rational relationship" test. *Western & Southern Life Ins. Co. v. State Bd. of Equalization of California*, 451 U.S. 648, 657, 101 S. Ct. 2070, 68 L. Ed. 2d 514 (1981). Under that test, a court must ask whether a challenged statute "is rationally related to achievement of a legitimate state purpose." *Id.* The key question in determining whether the challenged statute meets that test has been subdivided by the Supreme Court of the United States as follows: "(1) Does the challenged legislation have a legitimate purpose? and (2) Was it reasonable for the lawmakers to believe that use of the challenged classification would promote that purpose?" *Id.* at 668, 101 S. Ct. 2070.

Taxpayers arguing that a state taxation statute violates the Equal Protection Clause of the Federal Constitution carry a heavy burden. For example, the Supreme Court has stated

that "[p]arties challenging legislation under the Equal Protection Clause cannot prevail so long as 'it is evident from all the considerations presented to [the legislature], and those of which [the court] may take judicial notice, that the question [whether the rational relationship test was met] is at least debatable.'" *Id.* at 674, 101 S. Ct. 2070, quoting *United States v. Carolene Products Co.*, 304 U.S. 144, 154, 58 S. Ct. 778, 82 L. Ed. 1234 (1938).

The Act creating the tax credits challenged here was adopted in direct response to the decision of the United States Supreme Court in *Ward*. The State contends that one of the purposes of the legislation was to encourage competition among insurers in rural areas of the state, thereby providing greater access to insurance for citizens of rural areas. This goal, the State argues, is met because insurers will be encouraged by the Office Credit to open more offices in the state, some of which will presumably be in areas not already dominated by their competitors, i.e., in rural areas. The State also argues that the Office Credit was designed to encourage the employment of Alabama citizens. The State contends that the Property Credit is designed to encourage all insurance companies, foreign and domestic, to invest in Alabama property.

Upon our consideration of the arguments made by the State and those made by the plaintiffs, and in light of the standards set out above, we conclude that the challenged credits do not violate the Equal Protection Clause of the Fourteenth Amendment. The tax credits employed reasonable classifications designed to reach the legitimate legislatively determined goals of encouraging investment in the state and encouraging insurers to employ Alabama citizens and to open offices in rural areas. Whether the challenged tax credits are rationally related to these goals is "at least debatable." It was reasonable for the members of the legislature to believe that these goals would be promoted by the adoption of the credits. Consequently, we conclude that the challenged credits do not

violate the Equal Protection Clause of the Fourteenth Amendment to the Federal Constitution.

CONCLUSION

The plaintiffs principally argue that the trial judge's ruling should be affirmed because, they say, the property and casualty section of the 1993 Act—i.e., § 27-4A-3(a)(3)—was structured to benefit "large" property and casualty insurers and unconstitutionally intrudes on their "economic rights."

The State's argument is summed up in its reply brief, as follows:

> "The [Insurance] Premium Tax Reform Act [of 1993] and the credits contained therein are both constitutional. The credits do not discriminate; they are available to every insurer that makes the same investment in the Alabama economy. The [Property Credit] encourages insurers to invest in real estate because by doing so, they can reduce their tax burden. Similarly, the [Office Credit] encourages insurers to hire new employees, or to open new offices, because by doing so, the insurers can reduce their tax burden. To the extent that the plaintiffs do not presently take advantage of the entire credit, they are encouraged to expand their businesses. The credits are there for them. That, quite simply, is the factual picture. And, assuming *arguendo* that the credits do discriminate between 'large' and 'small' property and casualty insurers, it is more than clear that under the rational relation [test] or the [state constitutional standards], the [Insurance] Premium Tax Reform Act is a constitutional statute. The [plaintiffs'] argument to the contrary is a constitutional challenge in name only. The [plaintiffs'] quarrel with the Act is at heart a policy debate; they argue that the credits are not optimal economic incentives. This Court has repeatedly stated that it will not be used to revise statutes in order

to foster private notions of economic efficiency and efficacy."

After considering all of the arguments, we agree with the State that under either the rational relationship test or the tests applied in determining compliance with the Alabama Constitution of 1901, the plaintiffs have not shown that the challenged statute is unconstitutional. Under settled principles of law, a court cannot substitute its judgment for that of the people's elected representatives. We conclude that the challenged tax credits have not been shown to violate either the Alabama Constitution or the Federal Constitution; we reverse the judgment of the trial court and remand the cause for further proceedings or an order consistent with this opinion.

Because we reverse and remand, we need not consider the remaining questions presented by the parties concerning severability and prospective or quasi- prospective application of the trial court's ruling.

REVERSED AND REMANDED.

HOOPER, C.J., and SHORES and KENNEDY, JJ., concur.

HOUSTON and LYONS[3], JJ., concur in part and concur in the result in part.

SEE, J., concurs in the result.

HOUSTON, Justice (concurring in part and concurring in the result in part).

I concur in the result. It is my firm and unwavering judicial opinion that the Constitution of Alabama of 1901 does not provide for equal protection, and that in Alabama, since

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[3] Justice Lyons was not a member of the Court when the case was orally argued, but he has listened to the tape of the oral arguments.

the ratification of the 1901 Constitution, the only equal protection is that provided by the 14th Amendment to the Constitution of the United States. *Smith v. Schulte*, 671 So. 2d 1334, 1338-39 (Ala. 1995) (Houston, J., dissenting); *Pinto v. Alabama Coalition for Equity*, 662 So. 2d 894, 901-10 (Ala. 1995) (Houston, J., concurring in the result); *Moore v. Mobile Infirmary Ass'n*, 592 So. 2d 156, 174-81 (Ala. 1991) (Houston, J., concurring in the result).

I refuse to strike down a duly enacted statute based upon a nonexistent constitutional provision.

LYONS, J., concurs.

APPENDIX B

IN THE CIRCUIT COURT OF
MONTGOMERY COUNTY, ALABAMA

ALABAMA MUNICIPAL INSURANCE CORPORATION; ET AL.	*	
Plaintiffs,	*	
v.	*	CASE NO. CV-95-516-PR
STATE OF ALABAMA; ET AL.	*	
Defendants.	*	

JUDGMENT

This cause came on for trial and on consideration of the evidence and law, the Court makes the following findings of fact and conclusions of law.

This cause involves a constitutional challenge of the insurance premium tax on property and casualty insurance companies in The Insurance Premium Tax Reform Act of 1993 (Acts 1993, No. 93-679). The Plaintiffs are eight property and casualty companies doing business in Alabama. They contend that the section of the Act applicable to property and casualty companies, § 27-4A-3(a)(3) *Code of Alabama*, 1975, violates the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution and similar provisions of the 1901 Alabama Constitution, because it creates unlawful classifications among taxpayers.

The section under scrutiny taxes property and casualty premium income (with certain exceptions) at 3.6%. Section 27-4A-3(a)(3) d.1 provides incremental credit up to 1% for a specified number of offices staffed by a specified number of employees.[1] Section 27-4A-3(a)(3) d.2 provides a credit of .1% for each one million dollars invested in real estate in Alabama up to an investment of ten million dollars or a maximum credit of 1%.[2]

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[1] 1. Alabama Insurance Office Facilities Credit

For each office owned or leased by an insurer in the State of Alabama and used for insurance operations, an insurer shall be entitled to a credit against the tax imposed by paragraph a. of this subdivision (3) according to the following schedule:

Number of Full Time Employees in Office	**Credit as a % of Premiums Taxable Under Paragraph a.**
1 - 3	0.0025%
4 - 10	0.0050%
11 - 50	0.0075%
51 or more	0.0100%

The total credit allowable for Alabama insurance officer facilities shall not exceed one percent of an insurer's Alabama premiums taxable at the rate specified in paragraph a. of this subdivision (3).

[2] 2. Alabama Real Property Investment Credit

For each $1,000,000 in value of real property investments in the State of Alabama, an insurer shall be entitled to a credit of 0.10 percent of its Alabama premiums taxable at the rate specified in paragraph a. of this subdivision (3). The total credit allowable for

The evidence presented at trial demonstrates without dispute that Alfa Mutual Insurance Company qualified for the maximum 1% Office Facilities Credit for the year 1995 through its office configuration and staffing. The evidence further demonstrates that Alfa qualified for the 1% maximum Real Estate Investment Credit through an investment of over ten million dollars in Alabama real estate. For 1995, Alfa had $298,015,564 in Alabama premium income subject to the 3.6% tax and by qualifying for both credits, reduced its tax rate to 1.6%. By so doing, it reduced its tax from $10,728,560 to $5,960,311. In 1995, Alfa had assets of $781,448,000 and more than 842 employees located in 152 offices in Alabama. Of the plaintiffs, only Southern Guaranty Insurance Company had more than $100,000,000 in assets. The value of the assets of the seven other plaintiffs range from $1,972,000 in the case of Liberty Southern Insurance Company to $27,332,000 in the case of Centennial Casualty Company. The positive premium income for the eight plaintiffs in Alabama ranges from $342,716 for Centennial Casualty Company to $13,167,820 for Safeway Insurance Company of Alabama. Six of the Plaintiffs have one office in Alabama and two have two. Two have no employees and the others range from one to 29, except Southern Guaranty which has 115.

Alfa is the only property and casualty company which qualifies for the full 2% credit. Allstate Insurance Company and the State Farm Group qualify for 1.17% and 1.215%, respectively. State Farm, Alfa and Allstate were the three biggest property and casualty companies in Alabama for 1995

Alabama real property investments shall not exceed 1 percent of an insurer's Alabama premiums taxable at the rate specified in paragraph a. of this subdivision (3).

in terms of premium income. No other property and casualty company realized a substantial benefit from the credits.

Of the plaintiff companies, two realized no credit. The credit realized by five plaintiffs ranges from .0025% to .02%. Southern Guaranty Insurance Company realized .3125% credit.

Under the taxing statute, it is easier for a large company to take advantage of the Real Estate Investment Credit than a small one. A company with less than one hundred million dollars in assets is effectively prohibited from investing as much as ten million dollars in real estate by § 27-41-34 *Code of Alabama*, 1975. Common business practices and prudence render the investment of, say, one million dollars in real estate more difficult for a company with ten million dollars in assets than for a company with five hundred million dollars in assets. Similarly, it is easier for a company doing a large amount of business in Alabama through employees to take advantage of the Office Facilities Credit, than a small one doing business through independent agents. The minimum number of offices a company must have to achieve the full credit is 100, staffed by 51 employees each, or a total of 5,100 employees. Alternatively, a company could have a minimum of 400 employees in 400 offices and realize the 1% credit. Each incremental fractional amount of Office Facilities Credit is more difficult to achieve for a small company doing business through independent agents than a large one doing business through employees. The taxing classification thus favors larger companies and concurrently burdens smaller ones.

The issue for this Court is whether this classification violates either the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution or similar clauses in the 1901 Alabama Constitution.

This Court is mindful of the broad area of discretion available to the Legislature in tax matters. This Court cannot substitute its preference merely because it disagrees with the legislative scheme.

The Alabama Supreme Court in *Robert Burton Associates, Ltd., et al. v. Ralph P. Eagerton, Jr., etc.*, 432 So. 2d 1267 (Ala. 1983) stated:

> 'The State must proceed upon a rational basis and may not resort to a classification that is palpably arbitrary. The rule often has been stated to be that the classification 'must rest upon some ground of difference having a fair and substantial relation to the object of the legislation.'

The Alabama Legislature provided no express purpose for the subject legislation. The State has postulated a number of conceivable purposes. The State's conceivable purposes fall into two broad categories. The first involves economic development including the promotion of insurance offices, employment and the insurance industry generally. The second involves the promotion of the availability of insurance, the encouragement of its use and the promotion of a vigorous insurance market. The analysis from a U.S. Equal Protection Clause standpoint is whether the classification has a fair and substantial relation to any asserted legitimate purpose. The analysis from the standpoint of Alabama Constitution 1901 is different. State scrutiny is more vigorous. Where the legislation affects protected economic interest or liberties, there must be in fact a demonstrable public need to be balanced against protected interest impaired by the legislation and the balance struck between the two must be reasonable and fair. *Mount Royal Towers v. Alabama Board of Health*, 388 So. 2d 1209 (Ala. 1980).

Both the Real Estate Investment and Office Facilities Credit may be achieved by pre-legislative activity. In fact, it appears that Alfa Mutual Insurance Company achieved both credits through real estate investment and an office staffing situation, that existed at the time of the passage of the Act. See *Hooper v. Bernalillo County Assessor*, 472 U.S. 612, 86 L. Ed. 2d 487, 105 S. Ct. 2862 (1985). The State claims that the legislation will result in considerable economic benefits such as construction and employment. The Act contains no requirement that there be economic activity as a condition to achieving either credit. The evidence shows that considerable economic activity must occur before the cost to the State of the subject credits is overcome. Only then would there be a net economic benefit to the State. The relationship between these economic goals and the classification is attenuated. See *Nordlinger v. Hahn*, 505 U.S. 1, 112 S. Ct. 2326, 120 L. Ed. 2d. 1 (1992). Also see *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869, 84 L. Ed. 2d 745, 105 S. Ct. 1676 (1985); *Town of Eclectic v. Mays*, 547 So. 2d 96 (Ala. 1989); *City of Birmingham v. Stegall Co., Inc.*, 439 So. 2d 91 (Ala. 1983); *Robert Burton Associates, Ltd., et al. v. Ralph P. Eagerton, Jr., etc.*, supra; *Thorn v. Jefferson County*, 375 So. 2d 780 (Ala. 1979). The credit allowed under this legislation for the specified office configuration and staffing by employees is in part a tax on the method of doing business by those companies which do not achieve the credit. See *Rochell v. City of Florence*, 237 Ala. 635, 188 So. 247 (1939). The evidence is conclusive that the legislation ultimately provides a subsidy for Alfa and to a lesser extent Allstate and State Farm and as such, does not encourage vigorous competition, but tends to encourage monopoly inconsistent with Article IV, § 103, Alabama Constitution 1901. The classification also appears to be inconsistent with settled state law or policies concerning the sound solvency

regulation of insurance companies, free competition and fundamental economic rights. As such, some asserted purposes could be considered pretextual. See *Nordlinger v. Hahn*, supra; *Allegheny Pittsburgh Coal Co. v. County Commission*, 488 U.S. 336, 109 S. Ct. 633, 102 L. Ed. 2d 688 (1989); *City of Council of Montgomery v. Kelly*, 142 Ala. 552, 38 So. 67 (1904); *State of South Dakota v. American Bankers Insurance Company*, 374 N.W. 2d 609 (S.D. 1985).

The State argues that distinctions based on size are constitutionally permitted, citing *Carmichael v. Southern Coal & Coke Company*, 301 U.S. 495, 57 S. Ct. 868, 81 L.Ed 1245 (1937); *Eagerton v. Exchange Oil & Gas Corp.*, 404 So. 2d 1 (Ala. 1981); *National Motor Fleets, Inc. v. Brown*, 282 Ala. 572, 213 So. 2d 570 (1968); *Caiola v. City of Birmingham*, 262 So. 2d 602 (Ala. 1972); *State v. Pure Oil Co.*, 256 Ala. 534, 55 So. 2d 843 (1951). In *Caiola*, it was stated:

> "For example, where size is an index to the evil at which the law is directed, discrimination between large and small are permissible."

In *Carmichael*, it was stated:

> "It is only a difference in numbers which marks the moment when day ends and night begins, when the disabilities of infancy terminate and the status of legal competency is assumed. It separates large incomes which are taxed from the smaller ones which are exempt, as it marks here the difference between proprietors of large businesses who are taxed and proprietors of small businesses who are not." *Carmichael*, pg. 1253.

These case do not justify a greater tax burden on smaller, poorer companies but rather justify a higher burden on those

with a greater ability to pay. See reasoning in *Kahn v. Shevon*, 416 U.S. 351, 40 L. Ed. 189, 94 S. Ct. 1734 (1974); *Stewart Dry Goods Company v. John B. Lewis, et al.*, 294 U.S. 550 (1935) and *Fox v. Standard Oil Company of New Jersey*, 294 U.S. 87, 79 L. Ed. 780 (1935).

Upon consideration of all of the evidence and applicable law, the Court finds and concludes that for the reasons hereinafter stated, it is unnecessary to reach the issue of whether the subject legislation violates the U.S. Constitution. This case involves a protected economic interest or liberty under Alabama Constitution 1901, §§ 1 and 35. This right was recognized in *City Council of Montgomery v. Kelly*, 142 Ala. 552, 38 So. 67 (1905):

> "The above cited cases are in accord with our decisions which hold that the liberty which is so sedulously guarded by the Constitution, includes the right to pursue any useful and harmless occupation, and to conduct the business in the citizens' own way, without being discriminated against either by being prohibited from engaging in it or by being burdened with discriminative taxation. * * * "

In *Alabama Independent Service Station Association v. McDowell*, 242 Ala. 424, 6 So. 2d 502 (1942), it was stated:

> "The doctrine of the Kelly case has been repeatedly followed, not only by this court but by the courts of other states. *State v. Goldstein*, supra; *City of Mobile v. Rouse*, 233 Ala. 622, 623, 173 So. 266, 111 A.L.R. 349; *People v. Victor*, supra, and authorities cited on pages 669, 670 of 283 N.W.
>
> "Said Act 607, in the respect indicated, violates the provisions of our Bill of Rights, Const. 1901, §§ 1 and

35; *City Council of Montgomery v. Kelly*, supra, *State v. Goldstein*, 207 Ala. 569, 93 So. 308; *City of Mobile v. Rouse*, supra; *Barton v. City of Bessemer*, 234 Ala. 20, 173 So. 626."

In *Mount Royal Towers v. Alabama Board of Health*, 388 So. 2d 1209 (Ala. 1980), it was stated:

> "We hold that, where legislation affects protected economic interests or liberties, it must be tested against the public purpose sought to be served, and there must be a legitimate bona fide relationship between a permissible public purpose and legislation passed to further that end. Or, stated differently, there must be in fact a demonstrable public need to be balanced against protected interests impaired by legislation, and the balance struck between individual rights and the public welfare must be reasonable and fair. Factors which may be taken into account in this assessment are the degree of the burden which the legislation imposes, the importance of the right infringed upon, and the gravity of the conditions with which the legislation attempts to deal. This is not a departure from the rule followed in earlier cases, but merely a rearticulation of the test. *Franklin* itself, which established the affected public interest test, defined the issue in determining the validity of economic regulation attacked upon constitutional grounds to be 'whether the relief intended to be given is of a character appropriate to the existing emergency, and reasonably intended to protect against, or to alleviate, the calamitous conditions prevailing or threatened.' 169 So. at 298."

The reasoning in *Mount Royal* has been affirmed in *State Ex Rel. Galanos v. Mapco Petroleum*, 519 So. 2d 1275 (Ala. 1987).

The above and foregoing federal cases are persuasive and helpful in this Court's analysis of the State constitutional challenge. This Court finds and concludes that the subject tax discriminates in favor of large companies and burdens small ones. The Court finds no demonstrable public need which could justify such discrimination under the means-end test set forth in *Mapco* and *Mount Royal*.

The Plaintiffs seek a holding that § 27-4A-3(a)(3) is unconstitutional. The State suggest that if anything is held unconstitutional, it should be the credits. The issue of severability is governed by *Baron-Leggett Electric, Inc. v. Department of Revenue*, 336 So. 2d 1124 (Ala. Civ. App. 1976). The Court finds that the credits are an integral part of the section taxing property and casualty companies and cannot be severed from it. There is no evidence that the Legislature would have enacted the section without the credits in it. There is considerable evidence that the section would never have been passed without the credits in it. Accordingly, it is the holding of this Court that § 27-4A-3(a)(3) *Code of Alabama*, 1975 is unconstitutional and void under Alabama Constitution 1901 §§ 1 and 35.

The State argues that the retroactive application would cost the State $91,000,000 annually in premium tax collections. A prospective application of this ruling would cost the State no tax revenues provided the Alabama Legislature acts in a timely fashion. A quasi prospective application of this ruling would operate similar to a prospective one, but would afford relief to the plaintiffs in this case. Decisions with respect to retroactive or prospective application of rulings on constitutional law are subject to judicial discretion on a case-by-case basis. *Hosea O. Weaver & Sons, Inc. v. Towner*, 663 So. 2d. 892 (Ala. 1995); *State v. Morrison Cafeterias Consolidated, Inc.*, 487 So. 2d 898

(Ala. 1985). The equities of this case do not support the imposition of a severe financial burden on the State of Alabama and its citizens, therefore, there shall be no retroactive application of this ruling. The equities do dictate that the present Plaintiffs be rewarded and that similar litigants be provided an incentive to challenge existing law in need of reform.

Therefore, it is ORDERED, ADJUDGED and DECREED as follows:

1. That § 27-4A-3(a)(3) *Code of Alabama*, 1975 is unconstitutional as violative of Alabama Constitution 1901 §§ 1 and 35.

2. The Plaintiffs, Alabama Municipal Insurance Corp., American Colonial Insurance Co., Inc., American Mining Insurance Co., Inc., Baldwin Mutual Insurance Co., Centennial Casualty Co., Liberty Southern Insurance Co., Inc., Safeway Insurance Co. of Alabama, Southern Guaranty Insurance Co., are entitled to a refund of all taxes paid under and by virtue of the provisions of § 27-4A-3(a)(3) *Code of Alabama*, 1975 and the Clerk of this Court is hereby ordered to refund to the parties the taxes heretofore paid into Court. Said Plaintiffs are hereby relieved of making any further tax payments under said section.

3. As to all other taxpayers, this ruling shall apply prospectively and all taxes due from said taxpayers due as of this date shall be due and owing the State of Alabama and shall not be refunded. Hereafter Section 27-4A-3(a)(3) *Code of Alabama*, 1975 shall be void and no taxes shall be collected under it.

DONE this 11 day of June, 1997.

/s/ Charles Price
CIRCUIT JUDGE

APPENDIX C

IN THE SUPREME COURT OF ALABAMA

February 19, 1999

No. 1961555

STATE OF ALABAMA, ET AL.

v.

ALABAMA MUNICIPAL INSURANCE CORPORATION, ET AL.

(Montgomery Cir. Ct. No.: CV-95-516)

NOTICE

The application for rehearing filed in this cause is overruled. No opinion written on rehearing.

MADDOX, J. - Hooper, C.J., and Houston, Kennedy, See, Lyons, and Brown, JJ., concur.

APPENDIX D

CODE OF ALABAMA

Section 27-4A-3. Premium taxation rates.

(a) Subject to the exceptions and exemptions hereinafter set forth, for the year beginning on January 1, 1995, and for each year thereafter, every insurer shall pay to the commissioner a premium tax equal to the percentage, as set out in this subsection (a), of the premiums received by the insurer for business done in this state, whether the same was actually received by the insurer in this state or elsewhere:

* * *

(3) Premium Tax on Other Insurance Premiums.

a. Except as hereinafter provided, the rate of taxation on insurance other than life insurance, health insurance, and accident health insurance shall be 3.6 percent per annum.

b. Premiums for all of the following types of insurance shall be taxed at the rate of one percent per annum:

1. All property and multi peril insurance written in fire protection Classes 9 and 10.

2. Mobile homes, mobile homeowners, homeowners and low value dwelling policies in a face amount of $40,000 or less.

c. Premiums for medical liability insurance shall be taxed at the rate of 1.6 percent per annum.

d. The tax imposed at the rate specified in paragraph a. of this subdivision (3) shall be reduced by the following credits for certain economic development activities pursued in the State of Alabama.

1. Alabama Insurance Offices Facilities Credit.

For each office owned or leased by an insurer in the State of Alabama and used for insurance operations, an insurer shall be entitled to a credit against the tax imposed by paragraph a. of this subdivision (3) according to the following schedule:

Number of Full Time Employees in Office	**Credit as a % of Premiums Taxable Under Paragraph a.**
1 - 3	0.0025%
4 - 10	0.0050%
11 - 50	0.0075%
51 or more	0.0100%

The total credit allowable for Alabama insurance office facilities shall not exceed one percent of an insurer's Alabama premiums taxable at the rate specified in paragraph a. of this subdivision (3).

2. Alabama Real Property Investment Credit.

For each $1,000,000 in value of real property investments in the State of Alabama, an insurer shall be entitled to a credit of 0.10 percent of its Alabama premiums taxable at the rate specified in paragraph a. of this subdivision (3). The total credit allowable for Alabama real property investments shall not exceed 1 percent of an insurer's Alabama premiums taxable at the rate specified in paragraph a of this subdivision (3).

(i) Alabama real property investments which qualify for the Alabama real property investment credit include any improved Alabama real property owned by the insurer or an affiliate of the insurer on January 1, 1993, and any improved or unimproved Alabama real property acquired

or new construction placed in service on or after January 1, 1993, by the insurer or an affiliate of the insurer.

(ii) For purposes of determining the Alabama real property investment credit, Alabama real property investments shall be valued at cost and not at book value or fair market value. The cost of capital improvements to existing Alabama real property investments, such as the renovation of shopping centers, hotels, or other buildings, completed and placed in service by the insurer or an affiliate of the insurer on or after January 1, 1993, shall be considered an Alabama real estate investment.

(iii) For purposes of determining the value of Alabama real property investments, funds borrowed to finance Alabama real property investments shall be subtracted from cost so that only the net cost in the investment properties borne from assets belonging to the insurer or an affiliate of the insurer qualifies for the Alabama real property investment credit. The cost of debt-financed Alabama real property investments of an insurer shall be increased pro tanto as the underlying debt is paid off by the insurer or an affiliate of the insurer.

(iv) The Alabama real property investment credit shall not be allowed for properties in the State of Alabama used in an insurer's insurance operations and for which the Alabama insurance office facilities credit is allowed or allowable, without regard to the 1 percent limitation on the credit. However, the cost of real property owned in the Statute of Alabama and used in part as an Alabama real property investment and in part for the insurer's insurance operations shall be allocated on a square-foot basis so that the cost allocated to that portion of the property not used for insurance operations shall qualify for the Alabama real property investment credit.

(v) Mortgages held by an insurer that are secured by real property located in the State of Alabama shall not be considered Alabama real property investments for purposes of the Alabama real property investment credit.

3. Special Rules.

The following special rules apply to the Alabama insurance office facilities credit and the Alabama real property investment credit.

(i) For purposes of determining the economic development credits allowed under this section, the term affiliate shall mean any business entity, other than a life or health insurance company, which is wholly owned by the insurer subject to tax under paragraph a. of this subdivision (3) or any other insurer and its wholly owned subsidiaries, other than a life or health insurance company, which is part of a group of companies, including the insurer, which are under common control and management. For an insurer having affiliates, all premiums of the insurer and its insurance company affiliates subject to tax at the rate specified in paragraph a of this subdivision (3) may be aggregated; all Alabama insurance office facilities and all Alabama real property investments may be aggregated; and, subject to the specific credit limitations, the total allowable tax credits may be determined as if all the aggregated premiums, office facilities and Alabama real property investments were owned by one insurer. Once the total allowable credits have been determined, the credits may be allocated to the insurer and its insurance company affiliates at the sole discretion of the insurer subject to the specific credit limitations on a per insurance company basis. The computation of allowable credits and their allocation to affiliates shall be made on forms to be supplied by the ,Alabama Department of

Insurance, which forms shall be filed with the insurer's annual statement.

(ii) Economic development credits allowed to foreign insurers shall be treated as Alabama premium taxes paid by the insurers for purposes of calculating any retaliatory tax due under Section 27-3-29.